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ABSTRACT

This document presents findings of a General Accounting Office (GAO) study that reviewed the experiences of three states that had recently reformed their school-finance systems to make them more equitable. Case studies of Tennessee, Texas, and Minnesota were conducted. Methodology included a review of school finance documents and legislative challenges to the states' school-funding plans; analysis of data on state budgets, student demographics, and school-district funding levels; and interviews with 15 to 19 education officials and representatives from statewide education associations in each state. Officials reported that legislative solutions following legal challenges in all three states lessened disparities in terms of access to revenue, per-pupil spending levels, or educational opportunities. Poor districts were helped without harming the education programs in wealthy districts. In response to budgetary and political pressures, legislatures in each state included hold-harmless and win-win provisions. However, the solutions are sensitive to public sentiments about taxes and may be subject to change. Officials advised other states undertaking similar reforms to clearly define the equity goals of the school-finance system in terms of adequate learning resources or student performance standards; link school-finance reform to accountability; and include all stakeholders in the reform process. Three tables are included. Appendices contain methodological notes, a list of officials interviewed for the case studies, findings of each of the case studies, and GAO contacts and acknowledgments. (LMI)

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ED 391 246

United States General Accounting Office
GAO
Report to Congressional Requesters

December 1995

SCHOOL FINANCE

Three States' Experiences With Equity in School Funding

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GAO

United States
General Accounting Office
Washington, D.C. 20548

Health, Education, and
Human Services Division

B-261604

December 19, 1995

The Honorable Jeff Bingaman
The Honorable Christopher Dodd
The Honorable Paul Simon
United States Senate

Since the 1960s, the federal government has targeted educational funds to areas of greatest need. For example, we commented on federal efforts to award Elementary and Secondary Education Act grants to localities with the greatest need.[1] More recently, the federal government has also encouraged states and localities to develop high academic standards for all school-age children. The system used to finance local schools within each state can affect whether students in all districts can realistically achieve such standards. In most states, these systems rely heavily on local property wealth, which can vary greatly from district to district.

Since about 1989, more than half of the states have been involved in lawsuits alleging that disparate access to education revenues violates the state's responsibility to provide for the education of all students. As a result, many state legislatures have modified their school finance systems.

To better understand state school finance issues, you asked us to review the experiences of selected states that had recently reformed their school finance systems to make them more equitable. Specifically, for each state selected, you asked us to characterize (1) the reforms to the school finance systems and the legal, budgetary, and political pressures the state legislature faced in making the revisions and (2) the general impact of the legislative remedy, especially in addressing disparities in educational funding. You also asked us to determine what advice state officials could provide for other states similarly reforming their school finance systems.

To answer these questions, we conducted case studies of three states—Tennessee, Texas, and Minnesota. (See app. I for a detailed discussion of methodology.) In selecting which states to study, we first asked experts in education finance to identify states that had implemented finance equity reforms. Then, for each state identified, we contacted state education officials or reviewed materials relevant to the state's school finance system to obtain information on finance formulas; school finance legislation; revenue-raising strategies; and limitations, if any, on

[1]See Title I Formula in S. 1513 (GAO/HEHS-94-190R, June 7, 1994) and Remedial Education: Modifying Chapter 1 Formula Would Target More Funds to Those Most in Need (GAO/HRD-92-16, July 28, 1992).

discretionary spending on local districts. We also considered each state's demographic makeup, reviewing such factors as the concentration of poverty and public school enrollment and growth rates. We selected Tennessee, Minnesota, and Texas for in-depth review because they had recently reformed their school finance systems and differed substantially from each other in (1) the approaches taken to revise their finance systems and (2) such demographic factors as poverty and student enrollment rates. Analyzing the school finance systems in three states with such broad variation increases the likelihood that findings common to all three states would be relevant to others trying to make their school finance systems more equitable. For each state selected, we reviewed school finance documents and analyzed data on state budgets, student demographics, and school district funding levels. We also interviewed a variety of education officials, about 15 in each state, including legislators, state finance and education officials, and representatives from statewide education associations (see app. II for a list of the titles of the interviewed officials). We conducted our study between April and October 1995 in accordance with generally accepted government auditing standards.

Results in Brief

Just as the federal government has targeted grants to localities with the greatest need, some states have been taking steps toward making school funding more equitable among districts, often as a result of court-imposed decisions. In the three states we studied, lawsuits led each state to address disparities in education funding among districts. Texas had $14 million in taxable property wealth per pupil in its wealthiest district, while the least wealthy district only had $20,000 in taxable property wealth per pupil. As a result of court action, Texas took a number of actions. For example, they limited taxable property wealth per pupil to $280,000.

Legislative solutions following legal challenges in all three states lessened disparities; they also helped poor districts without harming the education programs in wealthy districts. For example, Minnesota increased the funds available to low-property wealth districts and limited the local contributions districts could make. However, provisions in Minnesota's school finance reform legislation allowed some wealthy districts to keep what they had at the time of the legislation, even if it exceeded the new limits. Solutions in all three states were also sensitive to public sentiments about taxes. To build support for a sales tax increase to fund school finance reform, for example, Tennessee included accountability provisions in its legislation to ensure that any increase in spending would be used to improve student learning. Tennessee's small rural districts now have art

and music teachers and can offer courses that will better prepare their students for college.

All three states, however, have crafted solutions that may be subject to change. In Texas, for example, the current solution includes a state-imposed ceiling on property tax rates. This may make it difficult for some districts to raise sufficient revenue for burgeoning populations of educationally disadvantaged children, who characteristically cost more to educate. In another example, Tennessee's original solution to funding disparities—which specifically excluded teacher salaries as an allowable expense for the purpose of equalization—proved unsatisfactory to 77 small and rural districts. They felt that not being able to spend the money on increases in teacher salaries made it difficult for them to attract and retain teachers. Their lawsuit forced the 1995 legislature to include increases in teacher salaries in the school finance plan, so far costing the state $7 million.

Officials' advice to other states undertaking similar reforms centered on (1) clearly defining the equity goals of the school finance system in terms of the funding needed to either provide adequate educational resources for all students or to achieve a certain level of student performance, (2) linking funding reform with greater accountability for student performance, and (3) encouraging all groups affected by education finance reform to participate in making the decisions.

Background

Financing elementary and secondary education requires a large amount of money; in school year 1993-94, total expenditures in all U.S. elementary and secondary schools totaled an estimated $285 billion.[2] In most of the 50 states, education is the largest single expenditure category in the state budget, accounting for 20.3 percent of total state spending in fiscal year 1994. Elementary and secondary schools receive most of their funds from state and local revenues. Federal aid has mainly focused on providing services to educationally disadvantaged children through categorical, program-specific grants. In school year 1992-93, state and local shares of education spending were almost equally divided at 45.6 percent (or $113 billion) and 47.4 percent (or $118 billion), respectively, while the federal share was 6.9 percent (or $17 billion).

[2]Includes public and private elementary and secondary schools. For more information on education spending, see School Finance: Trends in U.S. Education Spending (GAO/HEHS-95-235, Sept. 15, 1995).

Funding Disparities Have Led to Court Challenges of Many State School Finance Systems

Disparities in the distribution of education funds can occur because of the method that states use to finance their public elementary and secondary schools. In most states, localities provide a major share of school funding, which is generally raised through the property tax (see table 1 for the funding sources in the states we analyzed). Because property wealth is not equally distributed among school districts, however, the heavy reliance on the local property tax produces disparities in districts' ability to raise education revenues.

Table 1: 1994 Sources of Public Elementary and Secondary School Education Revenues

	State revenue sources	Local revenue sources
Minnesota	Income tax Sales tax Motor vehicle excise tax Corporate tax Tobacco and alcohol taxes Other miscellaneous taxes	Property tax
Tennessee	Sales and use tax Taxes on tobacco and mixed drinks General fund revenues from a broad range of licenses, fees, and other sources	Property tax Optional sales tax
Texas	Sales tax Corporate franchise taxes Oil and gas production taxes Tobacco and alcohol taxes Lottery proceeds Interest and dividends Educational endowment fund	Property tax

Since the early 1970s, these disparities have led poor districts in more than 40 states to challenge the constitutionality of their state's school finance system. More than half of the state systems have been challenged since 1989—some for the second time. In most cases less wealthy districts charge that the state school finance system violated the state's constitution under one or two provisions—the education clause or the equal protection clause.

Role of Education Clause or Equal Protection Clause in Lawsuits

All states have an education clause or some provision in their constitution that requires the creation of a public school system. These clauses vary—some simply call for the creation of an education system, and others call for such systems to be, for example, "thorough and efficient" or "general and uniform." The courts in each state must interpret the substantive meaning of such clauses, on the basis of their wording and principles of statutory interpretation.

Equal protection clauses in state constitutions require that all individuals in similar situations be treated similarly. A suit brought under this provision must allege that an individual is being classified, or treated differently, by the state. In invoking the equal protection clause, claimants may, for example allege that the state discriminated against low-property wealth districts in providing education funds. In states where the highest court has found public education to be a fundamental state right, a standard of strict scrutiny applies. For a school finance statute to meet the standard of strict scrutiny, the court must be satisfied that a compelling government interest is at stake, a less discriminatory method to meet it does not exist, and the classification in the legislation is necessary to achieve a compelling government interest.

A Framework for School Finance Equity

Determining the equity of a state's school finance system, according to school finance experts, requires policymakers to consider the following four issues. First, policymakers must decide who is to benefit from an equitable school finance system, taxpayers or public school students. Second, the object that is to be equitably distributed must be determined. These objects include educational revenues or key educational resources, such as curriculum and instruction, or outcomes, such as student achievement. Third, the principle to be used to determine whether the distribution is equitable must be chosen. School finance experts have identified four principles for defining equity: (1) horizontal equity, in which all members of the group are considered equal; (2) vertical equity, in which legitimate differences in resource distributions among members of the group are recognized—for example, given childrens' differences, some students deserve or need more educational services than others; (3) equal opportunity, also known as fiscal neutrality, which means that differences in expenditures per pupil cannot be related to local school district wealth; and (4) effectiveness, which assesses the degree to which resources are used in ways that research has shown to be effective. The effectiveness principle suggests that a resource inequity exists not only when insufficient resources are available but also when resources are not used in ways that produce desired impacts on student performance. The fourth issue, according to experts, is to determine what statistic will be used to measure the degree of equity in the school finance system. Many statistical measures exist for this purpose; one such measure is the federal range ratio.[3]

[3]The federal range ratio is the difference between the values of the observations at the 95th percentile and the 5th percentile, divided by the value at the 5th percentile. In percentage terms, the ratio indicates how much larger the observation at the 95th percentile is than the observation at the 5th percentile.

Relationship Between Spending and Student Performance Unclear

Using the effectiveness principle to define equity requires knowledge of the use of education dollars to achieve certain desired student outcomes. However, the relationship among money, quality, and student achievement is not well understood.[4] As a result, school finance experts report that resources are not always used in ways that strengthen teaching and learning. As an expert with the Education Commission of the States recently suggested, better information is needed about what resources are necessary to create successful schools, what programs and services are valuable investments, and which ones result in the biggest payoff for students.[5]

Lawsuits Spurred Changes

All three states that we reviewed revised their school finance system at least partly in response to lawsuits, although the suits' outcomes differed initially. In each state, less wealthy districts filed suit claiming that disparities in the districts' access to education revenues violated the state constitution.[6] In Tennessee and Texas, the state supreme courts declared the school finance systems unconstitutional; in Minnesota, the state supreme court upheld the system because the disparities in revenue did not preclude the plaintiff districts from providing an education that met the state's basic requirements.[7] Nonetheless, the Minnesota State Legislature changed the system.

Lawsuits Focused on Disparities in Access to Revenues

The lawsuits in all three states focused on disparities in access to revenues. The greatest such disparity was in Texas, where the most wealthy district had $14 million in taxable property wealth per pupil, and the least wealthy district had $20,000 per pupil. Revenue disparities between the wealthiest and least wealthy districts were not necessarily

[4]For an example of a study that found no relationship between education resources and student performance, see E.A. Hanushek, "The Impact of Differential Expenditures on School Performance," Educational Researcher, Vol. 18, No. 4 (1989), pp. 45-51. For an example of a study that found a positive relationship between such variables, see R.D. Laine, R. Greenwald, and L.V. Hedges, "Does Money Matter? A Meta-Analysis of Studies of the Effects of Differential School Inputs on Student Outcomes," Educational Researcher, Vol. 23, No. 3 (1994), pp. 5-14.

[5]M. Fulton, "School Finance Must Support Education Reform," State Education Leader, Vol. 13, No. 2 (1994), pp. 1-3.

[6]Appendixes III through V provide a more detailed summary of school finance reform in each of the three states, including a discussion of the court cases.

[7]At issue in the lawsuit challenging Minnesota's school finance system was the equity associated with only 7 percent of the general education revenue available for elementary and secondary schools.

due to the unwillingness of less wealthy localities to tax themselves.[8] In Minnesota, for example, the plaintiffs' attorney said that the plaintiffs' analysis showed that the wealthiest 10 percent of districts in 1989 raised on average six times more revenue through a levy program than the poorest 10 percent even though tax rates for the poorest districts were on average 25 percent higher.

In Tennessee and Texas, the courts found that the differences in taxable wealth among districts created disparities in spending per pupil, which in turn led to such disparities in educational opportunities that some districts could not meet the state's basic education course requirements.[9] For example, in Tennessee, the disparity in total current funds available per pupil in 1987 (1 year before the lawsuit) meant that some districts spent more than twice as much as others—$1,823 per pupil compared with $3,669 per pupil. The disparity in funding, the Tennessee court concluded, deprived students in the plaintiff schools of equal access to adequate educational opportunities such as laboratory facilities; computers; current textbooks; buildings; and music, art, and foreign language courses.[10]

Only one court of the three—the Tennessee Supreme Court—linked inadequate funding of the plaintiff schools and educational outcomes. When the Tennessee suit was filed, only 7 percent of the elementary schools and 40 percent of the secondary schools in the state's 10 poorest districts were accredited by the Southern Association of Colleges and Schools, compared with 66 percent and 77 percent, respectively, of the 10 richest districts. Students in the plaintiff schools, the court observed, had poor standardized test results and a higher need for remedial courses in college.

Course of Lawsuits Varied Among States

In Texas and Tennessee, the state supreme courts initially found the states' school financing systems unconstitutional; subsequent legislative action led the state supreme courts to eventually uphold the revised finance systems as constitutional. Before the Minnesota Supreme Court's finding the school finance system constitutional, the legislature had

[8]School districts have taxing authority in Minnesota and Texas; counties and cities have such authority in Tennessee.

[9]Such disparities were not an issue in Minnesota, where the plaintiff districts stipulated that their district schools met the state's basic education requirements.

[10]See also School Facilities: America's Schools Not Designed or Equipped for 21st Century (GAO/HEHS-95-95, Apr. 4, 1995).

already made further changes to equalize more of the state education revenue. (See table 2.)

Table 2: Key Characteristics of State Lawsuits

Year lawsuit filed	Year of court decision	State supreme court decision on the constitutionality of the school finance system
Minnesota		
1988	1993	Constitutional—complete funding equalization was not required, and permitting wealthy districts to augment revenues did not violate equal protection requirements.
Tennessee		
1988	1993	Unconstitutional—the state failed to provide substantially equal education opportunities.
	1995	Constitutional—equalization may happen over several years, but equalizing or increasing teacher salaries should be part of plan.
Texas		
1984	1989	Unconstitutional—the concentration of funding resources—property wealth—violated the constitution.
	1991	Unconstitutional—legislative remedy failed to change the structure of the funding system.
	1992	Unconstitutional—legislative remedy violated the state constitution to not impose a statewide property tax.
	1995	Constitutional—legislative remedy changed funding system from one based on property wealth to one based on tax effort.

Regarding the two states whose systems the courts found unconstitutional, the Texas court's judgment was more prescriptive: It called for districts to have substantially equal access to similar revenue per pupil at similar levels of tax effort. This ruling followed the court's finding that a concentration of resources in very wealthy districts taxing at low rates should not exist while less wealthy districts taxing at high rates cannot generate enough revenue to meet even minimum educational standards. Holding that the state's school financing system violated a provision of the state constitution requiring educational efficiency, the court concluded that districts must have substantially equal access to similar revenue for similar levels of tax effort—regardless of property wealth. The Tennessee court found that the school finance system failed to

provide substantially equal educational opportunities to all students, leaving it to the legislature to devise a remedy.

Legislative Remedies Sought to Lessen Revenue Disparities

The remedies developed by the legislatures used one or more of the following options: (1) added new money to the school finance system to increase funding in poorer districts ("leveled up"), (2) redistributed the available resources by modifying the school finance formulas, (3) limited the local revenues in very wealthy districts ("leveled down"), or (4) recaptured local revenue from wealthy districts and redistributed it to poor districts. Each state approached crafting its solution differently (see table 3 and apps. III, IV, and V).

Table 3: Remedies Differ Among States

Remedy	Texas	Tennessee	Minnesota
Raised new revenue to increase funding in poorer districts		X	
Redistributed the available resources by modifying the school finance formula	X	X	X
Limited the ability of districts to raise local funding	X		X
Transferred local revenue from wealthy districts to poor districts	X		

Note: This table is based on the legislative remedies found to be constitutional by state supreme courts.

Tennessee Raised New Revenues and Initiated New School Finance Plan

Of the three states in our study, only Tennessee raised new revenues to improve access to revenues (leveled up), without placing limits on local contributions to education. Tennessee also revised its funding formulas by enacting a new school finance program in 1992. The program funded local school districts on the basis of the cost of providing a basic education[11] and determined the local share of this cost on the basis of a locality's fiscal capacity.[12] To finance the estimated $665 million needed to fund this

[11]Tennessee has determined that the essential components needed for a basic education include teachers for regular education, special education, and vocational programs; support staff, such as principals, librarians, counselors, and social workers; classroom items, such as textbooks, instructional materials, and technologies; and nonclassroom support associated with central office functions, pupil transportation, plant operation and maintenance, and capital outlay.

[12]Tennessee uses a regression model to estimate the fiscal capacity of counties. Factors in the model that determine local fiscal capacity include tax base, ability to pay, resident tax burden, and student population. In counties with more than one school district, each school district pays as much of its total basic education costs as the county is required to pay of its total costs for basic education.

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program, the Tennessee State Legislature passed a half-cent increase in its state sales tax and earmarked the new revenues for education. Under this program, every district received more funding per pupil than it would have under the old system, with less wealthy districts, as measured by their fiscal capacity, receiving proportionately more than wealthy districts.

Texas and Minnesota Redistributed State Funds and Limited Local Revenues

Texas and Minnesota redistributed state funds by changing the funding criteria in state aid formulas to favor low property wealth districts—without raising new state revenues. For example, Texas agreed to provide additional state aid to those districts whose per pupil property wealth was below $205,500[13] and who were willing to raise their property tax rate above the minimum required—$.86 per $100 of property value—up to a maximum of $1.50 per $100 of property value. Similarly, Minnesota chose to increase its aid to districts with low property wealth by agreeing to equalize a portion of the amount that districts raised through their optional operations levy.[14]

Furthermore, both Texas and Minnesota chose to limit local contributions (leveled down). In Minnesota, one education finance committee legislator said that the limit placed on levy revenue was as much a response to tax relief demands as it was an equalizing measure. In Texas, however, where property wealth of districts varied greatly, legislators set limits to meet the court mandate of "substantially equal access to similar revenue per pupil at similar levels of tax effort." The state could not afford to close the disparity in access to revenues by leveling up the revenue in less wealthy districts. The state, therefore, limited local contributions in two ways. First, the legislature limited the amount of revenue available to districts by "capping" the property tax rate at which localities could tax themselves. Second, the state chose to limit the taxable property value available per pupil to $280,000. Districts whose per pupil property values exceeded this threshold could choose one of five options to reduce their taxable wealth (recapture provision). Very wealthy districts generally chose one of two options to reduce their taxable wealth—writing a check to the state or to a less wealthy district.

[13]In 1995, the Texas State Legislature increased the per pupil property wealth ceiling from $205,500 to $210,000.

[14]The amount equalized is equal to 10 percent of the entitlement per pupil guaranteed by the state.

Reforms Reflected Many Pressures

The legislative reforms had to account for budgetary and political pressures. Budget pressures were related to competing demands of other budget sectors and to the growing student populations with special needs. The political pressures were related to concerns about the reforms' impact on taxes, the funding levels of high-spending districts, and maintaining local control of schools. In response to such pressures, legislatures in each state included hold-harmless and win-win provisions.

Medicaid, Corrections, and Growing Populations of Special Needs Students Exerted Budget Pressures

Legislators had to negotiate changes to state finance systems in a fiscal environment in which education and other costs were growing rapidly. On the basis of our analysis of state budget data, we found that Medicaid and corrections expenditures in all three states had grown substantially in the years before and during education finance reform. Medicaid spending had more than doubled in each state during that period. Although corrections spending had increased in all states, Texas' corrections spending increased most dramatically—by 135 percent from 1991 to 1995. We also found that these three states had similar education-related budget pressures from growing populations of special needs students, such as those requiring remedial and bilingual programs and those with disabilities, who are traditionally more expensive to serve.

Concerns About Taxes, Funding Levels, and Local Control of Schools Exerted Political Pressures

Other pressures were essentially political, reflecting the public's antitax sentiments and concerns for local education programs and for local control.

Solutions Reflected Tax Concerns of Public

In all three states, the reform process reflected the public's antitax sentiment, which precluded some proposed solutions. For example, in Tennessee, attempts to increase revenues for schools by implementing a first-time, broadly based income tax were defeated. Likewise, a statewide property tax in Texas was defeated. The solutions that were adopted also reflected antitax sentiments. To build the business community's support for a half-penny increase in Tennessee's sales tax to fund finance and other education reform, for example, the legislature included accountability measures ensuring that the new money would be used to purchase resources deemed important to improving education. Minnesota legislators limited the amount of per pupil revenue raised through a levy program based on property tax to be more fair to property owners as well as to limit (level down) local spending on education.

Win-Win Solutions Were Crafted for Wealthy and Less Wealthy Districts

Legislators had to respond to concerns from wealthy districts that sudden reductions or limitations in revenue would unfairly harm their education programs. As a consequence, Texas and Minnesota allowed hold-harmless exceptions in some wealthy districts either temporarily or permanently. These exceptions allowed districts to retain their educational revenues (Minnesota) or keep spending levels at existing levels by raising taxes (Texas). Similarly, a Tennessee legislator said that to build support for passage of the new school finance law, it was important to show that all districts would benefit from the new financing scheme.

State-Imposed Solutions Maintained Local Control

Local control was another major concern to legislators in two states. In Texas, consolidating tax bases among districts to facilitate sharing property tax revenues was vehemently opposed by those whose community identity was closely linked to district boundaries. Instead of requiring tax base consolidation, the legislature ultimately encouraged it as one of five options available to wealthy districts for redistributing their excess wealth. Allowing for local control of spending was also important in Tennessee, where the new school finance plan provided much more flexibility in spending compared with the old.

Reforms Improved Equity in Education Funding and Opportunities

Officials we interviewed reported that reforms to school finance systems have improved equity for less wealthy districts in terms of access to revenues, per pupil spending levels, or educational opportunities. Further, state education finance reports and our analyses of district spending data support their conclusion.

Officials in all three states reported improved access to revenues in less wealthy districts. We analyzed Minnesota state school spending data and found the following to support this view: in 1988, a less wealthy district generated expenditures of $59.57 per pupil for every percent of tax levied, compared with $84.98 per pupil for every percent of tax levied in a wealthy district. By 1992-93, however, the per pupil expenditures for every percent tax levied were essentially equal in less wealthy and wealthy districts.[15] In Texas, where the goal was to improve access to revenues by decoupling a district's education revenue from its property wealth, a legislative analysis[16] showed that tax effort rather than property wealth now explains the greatest amount of variance in a district's ability to raise revenues. In 1989, property wealth alone explained almost 70 percent of the variation in

[15]For this example, a less wealthy district is a district at the 10th percentile of relative wealth. A wealthy district is a district just above the 90th percentile.

[16]Texas Legislative Budget Board, "Fiscal Size-Up 1994-95 Biennium, Texas State Services."

a district's ability to raise revenue, while a district's tax rate explained only 13.5 percent. By 1995, property wealth explained only about 23 percent of the variation; tax effort explained almost 51 percent.

Both Texas and Tennessee reported diminished disparities in per pupil spending levels across districts, meaning that spending had increased in the less wealthy districts in each of these states. For example, a Tennessee school finance report showed that the disparity in per pupil expenditures between high- and low-spending districts dropped from 84 percent before the implementation of the 1992 finance system to 74 percent 1 year after implementation.[17] In our analysis of Tennessee school district funding data, we found that, the average total per pupil funding ($2,476) in the small, rural districts involved in the Tennessee lawsuit in the fiscal year before the 1992 implementation of Tennessee's new school finance system increased by 31.93 percent to $3,254 by fiscal year 1994-95. The remaining school districts experienced a 23.10-percent increase in their average total funding per pupil in the same period, with the average per pupil funding increasing from $3,117 to $3,782.

In Texas and Tennessee, where disparities in educational opportunities were such an issue that certain districts could not meet basic education requirements, officials we interviewed reported improvements in the learning opportunities for pupils in less wealthy districts. For example, in Tennessee, a former legislator said that small, rural districts now have art and music teachers, which they never had before, and can now offer courses that will better prepare their students for college. A 1994-95 Tennessee Department of Education budget report shows that districts spent the greatest share, about 80 percent, of the approximately $275 million in new funds made available to date on classroom-related expenses, particularly the hiring of new teachers to reduce kindergarten through eighth grade class sizes.

Equity Solutions Are Fragile and Prone to Change

Although officials we interviewed noted improvements in equity and other aspects[18] of their state school finance systems, they also shared concerns about their systems' sustaining these gains. Further, because of ongoing pressures from various interest groups, they observed that their revised

[17]In this example, the high-spending districts are at the 95th percentile and the low-spending districts at the 5th percentile.

[18]For example, in addition to improvements in equity, Tennessee officials saw the adoption of a cost-based financing scheme as a benefit of the new school finance system.

systems already have been modified and are likely to face further alterations. These officials noted the following concerns:

- continued reliance on local property taxes to finance education spending may lead to a tax backlash,
- features in the finance formula may not allow districts with high numbers of disadvantaged students to keep pace with rising educational costs, and
- districts may continue to press for changes in the school finance system.

Antitax Sentiment a Growing Concern

Observations made by Tennessee officials were typical of those regarding antitax sentiment. In Tennessee, where localities are required to pay a prorated share toward the cost of their district's basic education, a state school board official questioned the willingness of localities to raise their taxes to keep pace with rising expenses such as teacher salaries. One Tennessee education official said that, to avoid raising property taxes to pay for an increased local contribution, constituents may exert pressure to change the formula to reduce the local share, which may make it more difficult for the state to ensure the adequate and equitable financing of education needs in all districts.

In Minnesota, state education officials reported that districts are finding it increasingly difficult to pass optional levies to help pay for school operations—even since 1991, when the state increased its equalizing aid to districts that passed the levies. Minnesota officials view this development as possibly exacerbating the disparities among districts' access to revenues.

Difficulties in Meeting Increasing Educational Costs

Officials in all three states expressed concern about the ability of their state's school finance system to meet growing educational costs. For example, Texas education officials that we interviewed expressed concern about the impact of limiting the tax rate to $1.50 per $100 of property value. As more districts reach the $1.50 ceiling, their ability to increase spending to meet increased costs will be severely limited unless the state provides additional funding or the tax ceiling is raised. An official with an association that monitors the equity of Texas' school finance system said that "such a ceiling may be especially burdensome in less wealthy districts where the numbers of disadvantaged children with costly educational needs are growing rapidly." Similarly, an official with a large urban district in Minnesota said that "the state's cost adjustment factors are not adequate to fund the educational services needed for its disadvantaged

students." He said that his district, which is experiencing large increases in the number of disadvantaged children, "is considering suing the state to obtain increased funding."

Districts Continue to Press for Changes

Districts dissatisfied with the revised school finance systems have used legal or legislative means to change the systems. In a 1995 Tennessee Supreme Court case challenging the constitutionality of the state's new school finance system, the Tennessee Small School Systems claimed that the new funding scheme was unconstitutional because equalization would occur over several years and the plan included no provision to equalize or increase teacher salaries. In its February 1995 opinion, the state supreme court upheld the plan's constitutionality, accepting the state's argument that complete equalization of funding can best be accomplished incrementally, but found that the plan's failure to provide for the equalization of teachers' salaries was a significant defect which, if not corrected, could put the entire plan at risk. The 1995 Tennessee State Legislature has since appropriated $7 million of the estimated $12 million needed to equalize increases in teacher salaries.

In Texas and Minnesota, which both placed limitations on local contributions to education, officials reported that legislators face ongoing attempts by wealthy districts to change the school finance system. For example, according to officials in Texas, wealthy districts in Texas, unhappy over the recapture clause in the revised school finance system, convinced the Texas State Legislature to somewhat offset the payment they must make. The 1995 Texas State Legislature modified the school finance law to allow wealthy districts paying recaptured funds directly to the state to reduce the amount owed by the lesser of 4 percent or $80 per credit purchased.[19] A Texas education advocate said that provisions such as these subsidize wealthy districts at the expense of less wealthy districts.

Issues to Be Addressed by States Considering School Finance Reform

Because many other states face the prospect of reforming their school finance systems, we asked state officials what advice they had for other states. We found three common themes among their recommendations: (1) states should first clearly define equity goals in terms of the funding level needed to ensure adequate learning resources for all students or the funding needed to ensure a certain level of student performance, (2) states should link school finance reform to accountability, and (3) the reform

[19]The amount owed is based on the cost to educate additional children in the wealthy district, which is measured in attendance credits. Each credit purchased is added to the district's average daily attendance until the per pupil property wealth is no more than $280,000.

process should be inclusive and encourage the participation of all groups affected by such reform.

Clearly Define Goals of School Finance System

Officials in all three states suggested that states clarify the equity goals of a school finance system by defining such goals in terms of adequate learning resources or student performance standards. The general concern underlying this advice is that states need to know what they are purchasing with their education dollars. Officials suggested, for example, linking the amount of funding to either the level of resources needed to adequately meet the educational needs of students or to a certain level of student performance.

Link Finance Reform to Accountability

Officials also urged states to use student performance standards to provide accountability for increased spending on education. Officials said that the accountability was needed to convince parents and taxpayers that the increased spending would lead to improved student performance.

Include All Stakeholders in Reform Process

In discussing and developing proposals to reform the school finance system, the officials we talked to suggested including all interested parties with a stake in education, such as parents, teacher unions, school officials, and business community representatives. They also suggested that it is important for members from the legislative and executive branches of government and the different political parties to collaborate in crafting a workable solution. Officials in all three states provided examples of how they involved diverse groups in revising their school finance legislation. For example, one Minnesota official said that because the property tax system should work in conjunction with the education finance system, members of the primary and secondary education finance committees needed to include members of the legislature's tax committees in drafting proposals to change the education finance system.

Conclusions

The experience of the three states we studied suggests that reforming school finance systems to make them more equitable is complex and difficult. Legislative solutions have had to be sensitive to taxpayers' concerns about increased taxes and to concerns of wealthy districts that want to maintain existing spending levels. When these concerns are sufficiently considered to gain passage of finance reforms, disparities in education funding can be reduced and educational opportunities in poor

school districts improved. However, such negotiated solutions are fragile, making efforts to achieve equity continuous and likely to require periodic adjustments in school finance systems as student demographics and economic conditions change.

Solutions may use several options to increase the education funding in poor districts, such as generating new revenues or redistributing existing revenues. In states that choose to generate new revenues, it appears to be important to include accountability provisions to help convince taxpayers that the new investment in education is worthwhile.

Agency Comments

The Department of Education reviewed a draft of this report and had no comments. In addition, we provided state-specific information to state officials for verification and incorporated their technical suggestions as appropriate.

We are sending copies of this report to appropriate House and Senate committees and other interested parties. Please call Eleanor L. Johnson on (202) 512-7209 if you or your staff have any questions. Major contributors to this report are listed in appendix VI.

Linda G. Morra
Director, Education and
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Abbreviations

CPRE	Consortium for Policy Research in Education
SB	Senate Bill

Appendix I

Technical Appendix

The objectives of this study were to characterize, for each state reviewed, (1) the reforms to the school finance systems and the legal, budgetary, and political pressures the state legislatures faced in making the reforms and (2) the general impact of the legislative remedies, especially in addressing disparities in educational funding. We also determined what advice state officials could provide for other states similarly reforming their school finance systems.

To answer these questions, we conducted case studies of three states—Tennessee, Texas, and Minnesota.[20] We selected these states for in-depth review because they had recently reformed their school finance systems and differed substantially from each other in (1) the approaches taken to revise their finance systems and (2) such demographic factors as poverty and student enrollment rates.

For example, the three selected states collectively illustrate four different strategies for equalizing education finances—increasing revenues, redistributing revenues, limiting the contributions of localities to education, and recapturing funds from wealthy districts and redistributing them to less wealthy districts. With regard to demographic factors, the 1992 poverty rates in the three states ranged from 12.8 percent in Minnesota to 17.8 percent in Texas, with the national rate at 14.5 percent. The percent change projected in student enrollment from 1990 to 1993 ranged from 1.5 percent in Texas to 4.2 percent in Minnesota, with an overall projected increase for the nation at 4.3 percent.

Analyzing the school finance systems in three states with such broad variation increases the likelihood that findings common to all three states would be relevant to other states trying to make their school finance systems more equitable.

[20]For more information on national trends in education finance and the impact of state education finance reforms on school district revenues and spending patterns, see the following articles:

Adams, Jacob E., Jr., "Spending School Reform Dollars in Kentucky: Familiar Patterns and New Programs, But is This Reform?" Educational Evaluation and Policy Analysis, Vol. 16 (Winter 1994).

Goertz, Margaret E., "The Equity Impact of the Quality Education Act in New Jersey," Rutgers University, Consortium for Policy Research in Education (New Brunswick, N.J.: 1995).

Monk, David H., "Resource Allocation in Schools and School Systems" In International Encyclopedia of Education, Economics of Education Section (Oxford, England: 1992).

Odden, Allan R., "Trends and Issues in American School Finance," Rutgers University, The Finance Center of the Consortium for Policy Research in Education (New Brunswick, N.J.: 1994).

Picus, Lawrence O., "Texas School Finance Equity After Edgewood," Rutgers University, The Finance Center of The Consortium for Policy Research in Education (New Brunswick, N.J.: 1995).

For each state selected, we reviewed school finance documents and analyzed data on state budgets, student demographics, and school district funding levels. We also interviewed 15 to 19 individuals in each state who represented a variety of education interests (see app. II). In conducting the case studies, we primarily relied on the opinions of the officials we interviewed and the supporting documentation they provided.

State Selection

To select states to study, we first asked experts in education finance to identify states that had implemented finance equity reforms. Then, for each state identified, we contacted state education officials or reviewed relevant materials on the state's school finance system to obtain information on the state's finance formulas, school finance legislation, revenue-raising strategies, and limitations, if any, on discretionary spending on local districts. We also considered each state's demographic makeup, reviewing such factors as the concentration of poverty and public school enrollment and growth rates.

We asked six national education finance experts[21] to nominate states that had revised their school finance systems to address inequities in spending and had begun to implement the revised systems. The experts collectively nominated 18 states: California, Florida, Indiana, Kansas, Kentucky, Massachusetts, Maryland, Michigan, Minnesota, Missouri, Nebraska, New Mexico, South Carolina, Tennessee, Texas, Vermont, Washington, and Wisconsin.

To further refine the selection of states, we contacted state education finance officials or reviewed relevant materials on the state's school finance system to determine the following for each nominated state: (1) when the state passed legislation to equalize education spending, (2) the revenue sources used to finance the equalization effort, (3) the type of allocation formula used to distribute funds to the state's public schools, (4) whether the state operated under a tax or spending limit, and (5) whether any limits were placed on local contributions to education. We also used the most recent U.S. Department of Education National Center for Education Statistics data to obtain the 1990 and 1991 state, local, and federal share of education spending in each state.

[21]Kathy Christie, Education Commission of States; Mary Fulton, Education Commission of States; Margaret Goertz, Consortium for Policy Research in Education, Rutgers University; Allan Odden, Consortium for Policy Research in Education, University of Wisconsin-Madison; Lawrence Picus, Center for Research in Education Finance, University of Southern California; Terry Whitney, National Conference of State Legislatures.

Using this additional information, we first reduced the 18 states to 8 using the following criteria:

- To ensure that state officials would be able to recollect the circumstances surrounding the passage of the school finance reform legislation, we eliminated eight states that either had not passed such laws or had passed them before 1990: California, Florida, Maryland, New Mexico, South Carolina, Vermont, Washington, and Wisconsin.
- To ensure that school finance reforms had been in place long enough to allow us to study their effects, we eliminated one state (Michigan) where voters had only recently (March 1994) approved an increase in the general sales tax to fund a new school finance system passed by the legislature in December 1993.
- To ensure that we would study states that were not already the subject of many studies[22] and on the advice of one of the six experts, we eliminated one state (Kentucky).

Of the remaining eight states, we then judgmentally selected three that differed in their approaches to equalizing their school finance systems and differed substantially among certain demographic factors. We used the most recent Bureau of the Census data to obtain demographic information such as the 1992 poverty rate, recent shifts in kindergarten through 12th grade enrollment, and ethnicity.

Data Analysis

For each state selected, we reviewed school finance documents and analyzed data on state budgets, student demographics, and school district funding levels. We analyzed (1) the state's school finance system, laws, formulas, and spending patterns; (2) equity lawsuits dealing with state school finances; (3) state budget data for state spending and for education to determine the budget pressures operating when the state was considering school finance reform legislation; (4) student demographic data to identify any relevant trends in target populations, such as special education students, whose educational costs may be generally higher than average; and (5) school district spending data to verify where possible the impact new reforms have had on reducing funding disparities. We did not attempt to determine what impact the school finance reform had on improving student performance.

[22]See for example, J. Augenblick, An Evaluation of the Impact of Changes in Kentucky's School Finance Program, The SEEK Program: It's Structure and Effects, prepared for the Kentucky Department of Education by Augenblick, Van de Water, and Associates, 1991.

Interviews

We interviewed 15 to 19 individuals in each state who represented a broad array of interests in elementary and secondary education. Specifically, to obtain information and opinions on the state's effort to equalize education funding, we interviewed legislators; officials in the state education agency and the state board of education; state attorneys; state budget officials; and representatives of statewide education associations, such as teacher unions; associations for school administrators; and parent-teacher associations. We also interviewed individuals knowledgeable of both the plaintiffs' and the states' interests in the school finance equity lawsuits. See appendix II for a list showing the affiliation and position of the individuals we interviewed in each state.

The interviews were open ended. Major questions covered, but were not restricted to, the following subjects: (1) the problems placing the biggest demands on the state budget and their impact on funding for kindergarten through 12th grade education in general and, specifically, on the school funding scheme; (2) within the kindergarten to 12th grade education budget, what programs have been placing the biggest demand on the state's education budget, and what has been these programs' impact on public schools funding; (3) their satisfaction that the current education finance system provides an adequate education for all students; (4) their satisfaction that the current finance system provides for a more equitable distribution of state education funds; (5) the legal, political, and economic constraints that challenged state policymakers in developing the funding and allocation system and the way policymakers dealt with those constraints in developing the system; (6) the intended financial outcomes of the new school finance system and the extent to which the state has succeeded in achieving these outcomes; (7) the trade-offs that resulted or are anticipated from implementing the new finance system; and (8) advice for states that are trying to revise their school finance system.

Officials Interviewed for Case Studies

To conduct our case study, we interviewed the listed officials associated with the following state agencies and offices and education associations:

Minnesota

Minnesota House of Representatives

- Member of the Education Committee and K-12 Finance Division of the Committee
- Former Chair of the K-12 Education Finance Division of the Education Committee and member of the Ways and Means Committee (currently director of the St. Paul Children's Initiative)
- Ways and Means Fiscal Analyst/Education Finance
- Research Staff K-12 Education

Minnesota State Senate

- Vice Chair, Education Committee, and Vice Chair, Education Funding Division

Minnesota Department of Education

- Director of Finance
- Assistant Commissioner

Minnesota Department of Finance

- Team leader for Human Development Programs
- Executive Budget Officer

Minnesota Office of the Attorney General

- Assistant Attorney General

University of Minnesota, College of Education

- Professor, Department of Educational Policy and Administration

Minneapolis Public Schools

- Executive Director for Policy and Strategic Services

Minnesota Parent Teachers Association

- President-Elect

Coalition for Education Reform and Accountability

- Executive Director
- Former Director of the Minnesota Business Partnership

Schools for Equity in Education (formerly the Association of Stable and Growing School Districts)

- Executive Director
- Legislative Analyst

Association of Stable and Growing School Districts

- Plaintiffs' Attorney

White Bear Lake School District

- Superintendent of Schools

Tennessee

Tennessee House of Representatives

- Chairman of the House Education Committee

Tennessee Senate

- Current Chairman of the Senate Education Committee
- Former Chair of the Senate Education Committee and current lobbyist for the Tennessee School Systems for Equity

Tennessee Advisory Commission on Intergovernmental Relations

- Executive Director

Tennessee Department of Education

- Commissioner
- Assistant Commissioner

Tennessee State Board of Education

- Executive Director
- Executive Assistant

Tennessee Department of Finance and Administration

- Budget Coordinator
- Administrative Budget Analyst

Tennessee Office of the Attorney General and Reporter

- Solicitor General
- Associate Solicitor General

Tennessee Organization of School Superintendents

- Executive Director

Tennessee School Board Association

- Deputy Executive Director

Tennessee Education Association

- President
- Executive Director
- Research Manager

Superintendent of Crockett County Schools and former head of Tennessee Small School Systems, the group representing the plaintiff districts in the 1988 lawsuit

Texas

Texas House of Representatives

- Former legislator who chaired the House Public Education Committee

Texas State Senate

- Former senator who chaired the Senate Education Committee

Texas State Legislature, Legislative Budget Board

- Manager, Public Education

Texas Education Agency

- Associate Commissioner, Chief of Operations
- Chief Legal Counsel
- Coordinator, School Finance and Fiscal Analysis

Texas Attorney General Office

- Chief, General Litigation Division

Texas Association of School Boards

- Associate Executive Director for Research and Development

Texas Center for Educational Research

- Director

Texas State Teachers Association

- Director

Texas Association of School Administrators

- Executive Director
- Assistant Director

The Equity Center

- Executive Director
- Director of Member Services

Moak Consulting

- Principal of Moak Consulting

Texas Case Study

The Texas Supreme court held in 1989 that the state school financing system, which relied heavily on local property taxes, was unconstitutional. Since 1989, school finance issues in Texas have been dominated by legislative attempts to provide districts greater equity in their ability to raise revenue. The courts rejected two approaches passed by the Texas State Legislature before accepting a third, which has been in place since 1993.

Key characteristics of the new approach are (1) a mechanism for equalizing property wealth among districts and (2) revenue limits for all districts through a cap on property tax rates.[23] Included in the approach is transferring part of wealthy districts' property tax revenue to less wealthy districts. Districts were given a choice of five options for disposing of excess wealth. Most chose to simply write a check to the state. Caps were also placed on property tax rates. Finally, the level of state support to districts was linked to a formula that accounted for the districts' revenue-raising ability and tax effort.

Texas officials interviewed, who included former legislators, state officials, educators, and others involved in the years of legal and political controversy and the results that followed, believed that the new system has achieved greater equity. However, they also cite several concerns that could undermine the state's efforts to achieve equity, such as taxpayer resistance to the higher property taxes that have resulted.

Background

Funding for the 3.6 million students in Texas's 1,046 school districts totaled $19.5 billion in school year 1993-94. Of this, $17.3 billion was budgeted by local school districts. The largest share of the district-budgeted revenue, 50.4 percent, came from localities. The remainder came from the state (41.6 percent) and the federal government (8 percent). Part of the remaining $2.2 billion was used for items not budgeted by local districts such as textbook purchases and state matching contributions to the teacher retirement fund; the remainder was due to district underbudgeting of the revenue they actually received. Between 1985 and 1995, local funding increased by 117 percent, while state funding increased by 60 percent.

At the state level, elementary and secondary education is the largest item in the state budget (about 26 percent in fiscal year 1994). The primary

[23]A cap on property tax rates that existed before the finance reform was modified by the legislature in 1993 and 1995, according to officials.

source of state revenue for education is the sales tax; taxes on oil and gas production, corporation franchises, and tobacco and alcohol; lottery proceeds, interest and dividends, funds from the Available School Fund,[24] and other state fees and taxes provide the rest of the education revenue. At the local level, virtually all of the revenue is raised through property taxes.

Between 1990 and 1994, total expenditures for elementary and secondary education increased more than 34 percent. Much of this increase has been used to offset the rapid growth in the school-age population and increases in the number of special needs students. The cost of educating special needs students is generally higher than the cost of educating children without special needs.[25] Texas has one of the largest and fastest growing school-age populations in the nation. Between 1990 and 1994, the total number of students increased from 3.3 million to 3.6 million (8.6 percent). During that period, the number of special needs students increased at an even faster pace: students participating in special education increased almost 33 percent; students in bilingual programs increased almost 36 percent; and economically disadvantaged students increased more than 22 percent.

Disparities in Property Wealth and Access to Revenue Prompted Lawsuit

In 1984, a group of less wealthy school districts filed a suit (Edgewood v. Kirby) charging that the state's heavy reliance on property taxes to fund education resulted in expenditure differences that violated the Texas Constitution. The districts argued that the disparity in districts' property wealth limited the ability of less wealthy districts to raise adequate funds.

After a trial in 1987 and appeals through the state court system, the Texas Supreme Court in 1989 ruled that the finance system violated the constitutional provision for an "efficient" system. The court noted that glaring disparities existed in the abilities of less wealthy school districts to raise revenues from property taxes because taxable property wealth varied greatly by district. The wealthiest district had over $14 million of property wealth per pupil while the poorest had about $20,000. Many less wealthy districts were taxing themselves at a much higher rate than wealthy districts but producing far less revenue. As a result, less wealthy

[24]The primary revenue sources of this fund are one-fourth of the state motor fuels tax and investment earnings from the Permanent School Fund, which is an endowment fund consisting of state lands, the sale of lands, and royalty earnings.

[25]See School Finance: Trends in U. S. Education Spending (GAO/HEHS-95-235, Sept. 15, 1995) and School Age Children: Poverty and Diversity Challenge Schools Nationwide (GAO/HEHS-94-132, Apr. 29, 1994).

districts struggled to raise the revenue needed to fund programs that met the state's basic education requirements, while wealthy districts were able to pay for a wide array of enrichment programs.

The court said, "a direct and close correlation between a district's tax effort and the educational resources available to it" must exist. The court noted that although districts did not have to spend equal amounts per student, they must have substantially equal access to similar revenues.

Court Rejects Two Legislative Solutions

In response to the Texas Supreme Court decision, in June 1990, the legislature passed Senate Bill (SB) 1, a reform measure that provided more money for equalization but left intact the school finance system. Less wealthy districts appealed, and, in January 1991, the supreme court struck down SB 1, holding that the public school finance system still violated the "efficiency" provision of the Texas Constitution. The court said that, while SB 1 improved the school finance system, it still did not restructure the system to ensure that less wealthy districts had substantially equal access to revenue for similar tax effort. The court suggested the solution of either consolidating school districts or district tax bases.

Everyone we interviewed said that consolidating school districts was not a workable option because of negative public reaction. An official who was involved with writing the school funding legislation said, "many citizens see consolidation as a threat to local control and to the identity and economic viability of their community."

Rejecting the idea of consolidating school districts, the legislature created a system that would partially consolidate only the tax bases. This measure, SB 351, was signed into law in April 1991. It created 188 County Education Districts, which were countywide taxing entities encompassing several school districts with a cumulative property wealth no greater than $280,000 per pupil. These districts were to levy state-mandated property taxes and redistribute the revenues to their member districts on an equalized basis. This time the wealthy districts appealed, and, in January 1992, the Texas Supreme Court ruled that SB 351 was unconstitutional because it (1) violated the state constitution provision that prohibits a state property tax and (2) levied a school property tax without local voter approval. The supreme court gave the legislature until June 1993 to create a new school finance system.

When the legislature met in regular session in 1993, it submitted for voter approval a constitutional amendment legalizing the major SB 351 provisions. In May 1993, Texas voters defeated the measure by a wide margin. Then, with time running out and still trying to design a system that would not force district consolidation, the legislature passed a new measure, SB 7, in May 1993. In January 1995, the Texas Supreme Court upheld SB 7's constitutionality.

Current Approach Raises Less Wealthy Districts' Access to Funds, Limits Wealthy Districts' Spending

In developing a system that would meet the test of the state supreme court, the legislature chose not to develop a solution that required a further increase in state taxes, according to state officials and education advocates. The legislature had been putting more money into the system to address equity issues since the early 1980s and determined that to address the court's concerns, it would have to develop a solution that concentrated on redistributing local funding. Complicating the ability to find additional state dollars were rapid increases in expenditures for Medicaid and criminal justice programs. Between 1991 and 1995, state spending for Medicaid and criminal justice programs increased 117 and 135 percent, respectively.

The measure passed by the legislature and approved by the supreme court has several key features. It (1) creates greater equality in property wealth among districts, (2) sets limits on local property tax rates, and (3) provides supplemental state funding for less wealthy districts to equalize the revenue received on their local taxes.

Part of Wealthy Districts' Property Wealth Transferred to Less Wealthy Districts

The new mechanism in SB 7 that sets it apart from the other funding systems rejected by the court is a recapture provision that creates greater equality in property wealth among districts. This provision was enacted because other options for closing the gap in spending between the wealthy and less wealthy districts were limited, according to several people we interviewed. Politically, they said, the state could not pursue consolidation, and, financially, it could not raise the level of poor districts' spending to that of wealthy districts. Because of the vast disparities in property wealth, the estimated cost of the latter option was four times the amount of the entire state budget.

The new provision, which took effect in 1993, required districts with property wealth exceeding $280,000 per pupil to reduce their taxable wealth to no more than that amount. Districts had five options for doing

so: (1) consolidating with another district or districts, (2) transferring property to a poor district for taxation purposes, (3) purchasing attendance credits from the state (in effect, writing a check to the state), (4) contracting with another district to educate some of their students (in effect, writing a check to the district), or (5) creating a taxing district by consolidating the tax base with one or more other districts.

This provision affected 90 of the state's 1,046 school districts in school year 1993-94. Collectively, these districts had to reduce their property wealth, using one or more of the options, resulting in the recapture of more than $430 million in local property tax. Of these 90 districts, none used options 1, 2, or 5; 61 used option 3, 22 used option 4, and 7 used a combination of options 3 and 4.

SB 7 included a provision that allowed some of these districts to retain a greater amount of taxable wealth for the next several years. The provision, which expires in 1996,[26] permits wealthy districts to maintain their spending at 1992-93 levels and to retain enough property wealth to do so, subject to certain limitations.[27] This provision was included out of concern that rapid reductions could harm student programs, according to a state official.

Caps Placed on Property Tax Rates

To further limit spending of the wealthy districts, SB 7 capped school property tax rates at $1.50 per $100 of property value for all districts. Districts may call elections to increase the $1.50 limit by local voter authorization to no more than $2.00 for bonds and debt service.[28]

Level of State Support Linked to Revenue-Raising Ability and Tax Effort

Texas distributes state funds for public education through a two-tiered system of formulas known as the Foundation School Program. Tier I, a foundation formula, provides funds for meeting the state's basic education requirement. All districts are eligible to participate if they levy a property

[26]This provision was modified in the 1995 legislative session. The hold-harmless provision was extended until 1998 for districts that select either option 2 or 3; for districts that select options 1, 4, or 5, the provision expires in 1996.

[27]Districts were allowed to retain the property wealth needed to produce 1992-93 spending at a tax rate of $1.375 per $100 of property value in 1993-94 and $1.50 through 1995-96.

[28]The 1995 Texas State Legislature modified this limitation so that the $1.50/$100 property value tax limit is for maintenance and operations with the additional $.50 for servicing debt on bonds with the approval of the voters. The prior law limited both maintenance and operations and debt service to $1.50.

tax of at least $.86 per $100 of property value.[29] Tier II funding is designed to provide additional funds to enrich the basic foundation program and to offset the wealth of wealthy districts. Under the provisions of SB 7, participation in tier II funding is limited to districts with per pupil property wealth below $210,000.[30] These districts can receive tier II funding if they set their property tax rates above the level required for tier I funding—between $.86 cents and the maximum of $1.50 per $100 of property value.

Under this arrangement, less wealthy districts willing to tax themselves at higher rates will receive more state aid. Districts with per pupil wealth above $210,000, which can raise more revenue with equal tax effort than their counterpart districts below this level of per pupil wealth are not eligible to receive tier II aid. Districts with per pupil wealth below $210,000 receive tier II aid in direct proportion to the degree to which they are willing to raise their own tax rates.

More Equitable Funding and Greater Taxpayer Equity Cited as Successful Outcomes

State officials, former legislators, education advocates, and others we interviewed were unanimous in saying that the new system had greatly improved equity. They noted that compromises had to be made to increase the level of funding available to poor districts while not forcing school district consolidation across the state, but they said that the amount of progress towards greater equity had been substantial. For example, when the new system is fully implemented in 1999, the portion of unequalized revenue in the system will have decreased from nearly 21 percent of all state and local revenues in 1989 to less than 2 percent.[31]

Our interviewees regarded greater taxpayer equity as a significant outcome of the new system. Under the system in place in 1989, wealthy districts were able to raise large amounts of money at a low tax rate while less wealthy districts—even if they were taxing themselves at a much higher rate—could not raise the funds needed to provide an education program that met basic requirements. They pointed to evidence that the new system's limitations on revenue raised through the property tax in

[29]The tier I formula also includes weights for factors beyond the control of the districts such as special needs students and special adjustments that address the differences in the cost of education for rural and urban districts.

[30]In 1995, the state legislature increased the per pupil property wealth ceiling for tier II participation from $205,500 to $210,000.

[31]It has also been reported that Texas had made considerable progress in reducing the variation in per pupil spending among school districts before enactment of the school finance system embodied in SB 7, particularly in the years 1988-89 to 1992-93. See Lawrence O. Picus, "Texas School Finance Equity After Edgewood," The Finance Center of the Consortium for Policy Research in Education, August 1995.

wealthy districts and rewards to less wealthy districts for revenue raised through tax effort were affecting that disparity. For example, in 1989, more than 69 percent of the disparity among districts in per pupil revenue was due to differences in property values; by 1999, when the system has been fully implemented, almost 77 percent of the disparity will be due to differences in tax effort, according to estimates.

Officials Express Concerns That Inequities in State School Finance System Could Reemerge

While our interviewees cited accomplishments under the new system, they also collectively identified four concerns about inequities in the school finance system reemerging: (1) the continued heavy reliance on local property taxes, (2) wealthy districts' concerns about sharing their wealth, (3) less wealthy districts' concerns about continued differences in per pupil spending, and (4) districts' inability to meet rising costs.

Continued Reliance on Property Taxes

The Texas school finance system continues to rely on the local property tax for more than half of its total revenue—and under SB 7, local property taxes have increased. Wealthy districts have had to increase their property tax rates to offset the loss of state aid and maintain spending levels. In addition, many less wealthy districts have also increased their taxes because, under the tier II formula, the state rewards less wealthy districts that raise property taxes by increasing their state aid. Between 1990 and 1994, the effective property tax rate statewide has increased more than 43 percent, from $.96 per $100 of property wealth to $1.38. In 1994, 94 percent of the districts had a total effective tax rate that exceeded $1.00 per $100 of property wealth.

Almost all of those interviewed said that the new system had been designed to rely on the local property tax for most of its revenue to limit state government's costs. However, most officials expressed concerns about the state's reliance on the local property tax for such a large part of public education and said that they were concerned about a public effort to roll back tax rates in the future. In addition, in the fast-growing districts, funds needed to build schools are competing with funds needed to improve education programs, which decreases educational opportunity, according to an education advocate.

Wealthy Districts' Concerns About Sharing Taxable Wealth

Wealthy districts are dissatisfied with this new system and have pressured the legislature to make changes, according to state officials and education advocates. For example, in 1995, the legislature changed the provision that requires wealthy districts to reduce their taxable wealth. Under this change, those districts that write a check to the state (option 3) may reduce their costs through a discount and extend the hold-harmless provision for an additional 2 years.[32] In addition, the state is permitting wealthy districts to retain the money paid for appraising their district's property when such an appraisal is required to meet the recapture clause provisions. Continued pressure on the legislature to make changes that benefit the wealthy districts contradicts state efforts to improve equity between the wealthy and less wealthy districts.

Less Wealthy Districts' Concerns About Continued Differences in per Pupil Spending

Officials also noted that the new system did not bring something that poor districts had wanted—equality in per pupil spending with wealthy districts. Once the system is fully implemented, in 1999, it will permit wealthy districts to spend about $600 more per weighted pupil than less wealthy districts. The state supreme court indicated in its first ruling that although substantially equal yield for similar tax effort was required to meet the test of efficiency, a per capita distribution or equal spending per pupil was not. Despite the court ruling, however, the expected disparity in spending may be too much, according to some education advocates, given that $600 per pupil is a significant difference (for example, it equals $15,000 per 25-student classroom) that could give students in wealthy districts an advantage in financing educational opportunities.

Less Wealthy Districts' Inability to Meet Rising Costs

The effect of Texas' school finance system has been to provide more revenue for less wealthy districts while limiting the amount of revenue available to wealthy districts. Most officials said that they thought that the new system is achieving its goal—greater equity and more revenue for less wealthy districts. However, they also said that they have concerns about the system because of the statutory tax rate ceiling. As more school districts reach the $1.50 ceiling, their ability to increase spending to meet increased costs will be severely limited unless the state provides

[32]The reason for this change is that if the state collects the funds from the wealthy districts, rather than gives the funds directly to less wealthy districts through another option, it provides an estimated additional $35 million to allocate to districts throughout the state, according to a state official.

additional funding or the tax ceiling is raised.[33] This current tax rate could be particularly burdensome for fast-growing districts with large numbers of minority and economically disadvantaged students. At issue is whether these districts will be able to fund the costly services needed to meet students' needs. For example, in 1994, of the more than 445,000 students in the 123 districts with the lowest per pupil property wealth, 80 percent were minority students, 24 percent participated in bilingual programs, and almost 70 percent were economically disadvantaged.

[33]The 1995 legislature changed the system to (1) increase the per pupil basic allotment from $2,300 to $2,387, (2) increase the property wealth for tier II participation from $205,500 to $210,000, and (3) modify the $1.50/$100 property wealth tax ceiling so that in effect the ceiling is increased, according to a state official.

Tennessee Case Study

In response to a suit filed by small, rural districts, a state court ruled in 1991 that Tennessee's school finance system was unconstitutional, leaving it to the legislature to devise a remedy. This ruling came when efforts were already under way in the state to not only revamp the state's school finance system, but also to reform the management and academic curriculum of the state's public elementary and secondary schools as well. In a budgetary environment in which health and correction costs were increasing and facing political pressures to incorporate accountability and maintain local control, the Tennessee legislature passed legislation in 1992 to reform the school finance system.

Motivated by a potential court-imposed solution, the legislature increased the amount of state funds for education, funded it with a new half-cent sales tax, imposed accountability provisions, and crafted what has been described as a win-win solution that benefited all districts.

Legislators, state education officials, school district administrators, and others we interviewed said that the state has improved the educational opportunities of students in poor districts since 1992. Indicators of success included reduced spending disparities among districts, a large share of the funds going to classroom expenditures, and more educational opportunities (richer curriculum). Officials also praised other aspects of the revised school finance system, such as the cost-based approach to funding education and the flexibility districts have to spend their funds. However, officials we interviewed also identified several concerns dealing with a growing antitax sentiment, teacher salary increases, limits on local spending, the educational needs of the urban poor, and accountability. As a result of a 1995 supreme court decision, the state has taken action to finance teacher salary increases. Depending on how some of the other concerns are handled, officials suggested that inequities in the state's school finance system may recur.

Background

Spending for public elementary and secondary education in Tennessee totaled $3.4 billion in fiscal year 1994. State contributions, the largest share, amounted to 49.5 percent of the total, while local governments contributed 40.6 percent, and the federal government contributed 9.9 percent.

Most of the state funding for education, including higher education, is earmarked and primarily comes from Tennessee's 6-percent sales tax, the state's single largest tax revenue. The state does not levy property tax and

collects an income tax only on unearned income such as on stock dividends.[34] In fiscal year 1994, the sales tax amounted to about 65 percent of education funding. Additional sources of state revenue for education include other earmarked revenues, such as taxes on tobacco and mixed drinks, and general fund revenues from a broad range of licenses, fees, and other sources.

Property taxes and local sales taxes are the two major sources of local district tax revenues for elementary and secondary education. In school year 1993-94, property taxes accounted for 36.5 percent of local revenues in support of public schools, and local-option sales taxes accounted for 28 percent. The local-option sales tax allows localities to raise the 6-percent sales tax rate by as much as 2.75 percentage points. The state requires at least one-half of the local-option sales tax revenue to go to education.

Small, Rural Districts Sued State Over Funding Disparities

In 1988, the Tennessee Small School Systems, representing 77 of the 139 districts[35] in Tennessee, filed suit in chancery court against the state, claiming that, because of disparities in funding, the state school finance system violated the education clause and the equal protection requirements of the state constitution. Frustrations arising from the state's slow pace in enacting school finance reforms prompted the lawsuit. Our analysis of school year 1989-90 student data showed that districts involved in the lawsuit tended to be poorer than those who were not involved because the percentage of students eligible to participate in the free or reduced-price lunch program in a plaintiff district averaged about 37 percent compared with about 30 percent in a nonlawsuit district. However, almost 50 percent of Tennessee's students eligible to participate in the lunch program were in the nine large urban and suburban districts that intervened on the state's behalf out of concern for losing funding to rural districts.

The plaintiff districts asked the court to declare the state's school finance system unconstitutional, to enjoin the state from acting under the statutory school finance system, and to require the legislature to enact a constitutional school finance system. In September 1991, the chancery court ruled in favor of the small districts, finding that the school finance system violated the equal protection provisions of Tennessee's

[34]The income tax generated only 1.7 percent of the total state revenue available in fiscal year 1993-94.

[35]Tennessee systems are the local education agencies that operate elementary and secondary schools. For consistency in reporting, we refer to systems as districts.

constitution but delaying the effective date of its order until June 30, 1992, giving the legislature an opportunity to correct constitutional deficiencies.

State Supreme Court Ruled Existing System Unconstitutional

The state and a group of urban and suburban district intervenors appealed the 1991 chancery court ruling to the court of appeals, which reversed the lower court order; the case was then appealed to the state supreme court by the Tennessee Small School Systems. In 1993, the state supreme court ruled that Tennessee's school finance system was unconstitutional. The court found that the state failed to show a legitimate state interest justifying granting to some citizens educational opportunities that are denied to others and, thus, held that the school finance system violated the constitutional guarantee of equal protection.

The court found that the state equalized (that is, distributed funds on the basis of educational costs and ability to pay) less than $60 million of its $2.5 billion education expenditures and that none of the funds raised by the local-option sales tax were equalized. As a result, substantial disparity existed in the revenues available to the different school districts. In 1987, the disparity in total current funds available per pupil showed that some districts had more than twice as much as others—$1,823 per pupil compared with $3,669. The court found that the disparity was due to the state's reliance on local governments to fund education and local governments' varying ability to raise sufficient revenues and not necessarily due to an inadequate effort by localities to tax themselves. School districts with more retail activity and higher property values and commercial development had more funds to educate their children than districts with less retail activity and lower property values. As one official put it, "Not every county has a Wal-Mart."

The disparity in funding, the court concluded, led to students in the plaintiff schools not having equal access to adequate educational opportunities, such as laboratory facilities; computers; current textbooks; buildings; and music, art, and foreign language courses, some of which were required by the state. Further, plaintiff schools had difficulty retaining teachers, funding needed administrators, and providing sufficient physical education and other programs.

The court linked inadequate funding of the plaintiff schools to their educational outcomes. The court noted that, in the 10 wealthiest districts for the 1988-89 school year, 66 percent of the elementary schools and 77 percent of the secondary schools were accredited by the Southern

Association of Colleges and Schools compared with 7 percent and 40 percent, respectively, in the 10 poorest districts. The court observed that graduates from accredited high schools have better success in college acceptances. Students in the plaintiff schools, however, had poor standardized test results and more need for remedial courses in college.

Proposed Legislative Remedy Called for Increased Spending Despite Growing Budget Pressures

While the case was pending in chancery court and well before the 1993 supreme court decision, legislative leaders began to develop a remedy, building on the work of an ad hoc committee of statewide education officials formed by the Tennessee State Board of Education and making refinements as developed by officials in the Governor's administration. The committee had been analyzing Tennessee's school finance system since 1986, reported a State Board of Education official, and, by 1991, had developed and refined recommendations for a system. This system, termed the Basic Education Program, funded local school districts on the basis of the cost of providing a basic education[36] and determined the local share of this cost on the basis of a locality's fiscal capacity.[37] Assuming the state was responsible for funding about two-thirds of the total cost of the program, the governor's administration estimated, according to an Assistant Commissioner for Tennessee's Department of Education, that the additional state funds required would be $665 million, to be phased in over 6 years.

According to a budget coordinator in the state's Department of Finance and Administration, the call for increased spending on education came when the state was facing budget pressures from Medicaid and corrections. Enrollment growth was increasing Medicaid expenditures, and a prison construction program was fueling corrections expenditures, reported the budget coordinator. In our analysis of state budget data, we found that Medicaid expenditures increased by 103.6 percent from fiscal year 1988-89 to fiscal year 1991-92, while corrections expenditures increased by 19.8 percent during this period. Further, the budget coordinator said that demands to equalize the state's school finance

[36]Relying in part on guidance from the Southern Association of Colleges and Schools, the committee found that the essential components needed for a basic education included teachers for regular education, special education, and vocational programs; support staff such as principals, librarians, counselors, and social workers; classroom items such as textbooks, instructional materials, and technologies; and nonclassroom support associated with central office functions, pupil transportation, plant operation and maintenance, and capital outlay.

[37]Tennessee uses a regression model to estimate counties' fiscal capacity. Factors in the model that determine local fiscal capacity include tax base, ability to pay, resident tax burden, and student population. A proportionate share of the costs of the Basic Education Program is assigned to each school district on the basis of its county's relative capacity.

system posed the biggest education-related pressure on the budget for this period. However, he also said that costs associated with serving special education students—who were increasing at a faster rate than the general student population—also placed some pressure on the budget. In support of his opinion, we found that while Tennessee's net enrollment increased by 3.9 percent from 860,101 in school year 1987-88 to 893,272 in school year 1991-92, the number of special education students increased by 18.4 percent—from 129,725 to 153,634 over this same period.

Reforms Were Enacted Amid Legal and Political Pressures

In developing the specific legislation for the Basic Education Program, legislators faced at least two major challenges: first, how to raise the estimated $665 million needed in additional revenue to fully fund the program (level up the financing) and, second, how to equitably distribute funds among districts. In accomplishing these tasks, the legislature faced legal and political pressures.

Potential Court-Imposed Solution Spurred Legislative Action

The chancery court ruling and possible further court action motivated the Tennessee State Legislature to pass the Education Improvement Act, which established the Basic Education Program and funded it using the formula developed by the State Board of Education. The act also restructured the management of schools, set new academic standards, and mandated a new accountability system. The legislature then passed a half-cent sales tax increase to finance the act.

Accountability Provisions Countered Resistance

Regarding increased revenues, officials we interviewed, including key legislators at the time the new laws were passed, talked about the difficulty in convincing other legislators and members of the public that an increase in education spending was needed. Among the opposition were certain private education groups that believed any increase in funding for public education was a waste[38] and members of the business community who opposed a sales tax increase with no guarantee that the funds would improve education. Using an income tax to finance the plan proved not to be a viable option because the Tennessee governor tried and failed, in a special session, to pass what would have been the state's first broadly based income tax.

[38]See earlier comment in the "Background" section of the letter regarding the research that has examined the relationship between school expenditures and student learning.

Legislators and state education and other officials involved in crafting the legislation said that the inclusion of accountability provisions and the half-cent sales tax law were essential to passing the Basic Education Program. They cited key financial accountability provisions such as earmarking the revenue raised by the half-cent sales tax for education and specifying that revenues could not be spent on increases in teacher salaries—an expenditure many legislators believed was not linked to improvements in learning. They said that despite some opposition from teachers, school administrators, and some legislators, it was also important to include programmatic accountability provisions which, among other things, made local school officials accountable to the state for school district performance. For example, the law gave the Commissioner of Education power to remove from office local school board members or superintendents of districts that failed by school year 1994-95 to meet performance goals in such areas as student attendance rates and test scores. To facilitate this accountability, the law also required all districts to elect local school board members who in turn would be responsible for appointing a district superintendent. Districts previously had used a variety of methods to elect or appoint their local school officials.

Win-Win Solution Needed

Another challenge entailed devising an equitable allocation system, given that the state would not be at full funding for 6 years. The chair of the House Education Committee said that it was important to show legislative members that, with the increase in state spending, all districts, including large urban districts, were better off than they would have been under the old finance system. According to a state education official, the solution entailed adopting a wage adjustment factor developed by the state Department of Finance and Administration to ensure that the large, urban districts received more money under the new system compared with the old system. Then, because the money had to be phased in, the legislature chose to distribute the new money according to how close a district was to its full funding level. The farther away a district was from full funding, the more new money it proportionately received compared with a district that was closer to its full funding level.

Officials Cite Improvements as a Result of the Change

During our visit, Tennessee was in its third year of phasing in the Basic Education Program and was funding 88.1 percent of the fully funded level, $1.9 billion, for fiscal year 1994-95. Given this funding history, benefits of the program cited most frequently by officials we interviewed included

improved equity in the funding of poor districts compared with wealthy, greater educational opportunities for all—and, particularly, poor—districts, more flexibility in spending decisions at the local level, and the introduction of a cost-based finance system. District funding and expenditure data obtained from the state also indicate that inequities lessened since passage of the new finance program.

Improved Equity in Educational Funding

Tennessee's Department of Education reports that the new school finance system equalizes 94 percent of state funding to districts in support of elementary and secondary education in fiscal year 1994-95 compared with 62 percent in fiscal year 1991-92 under the old system. The increase in the amount of equalized funds has reduced the disparity in spending: the Tennessee Advisory Commission on Intergovernmental Relations reports that the disparity in per pupil revenues as measured by how much larger the per pupil revenue in the district at the 95th percentile is than the per pupil revenue in the district at the 5th percentile has declined from 83.9 percent before the enactment of the Education Improvement Act in 1992 to 73.6 percent after 1 year of Basic Education Program funding. The commission estimated that the disparity will fall to 36.1 percent by 1997, the year the Basic Education Program is fully funded.

We found that plaintiff districts benefited to a greater extent than the other districts under the new financing program. In our analysis of Tennessee school district funding data, we found that, the average total funding per pupil in the 77 small, rural plaintiff districts has increased. In the fiscal year before the 1992 implementation of the new finance program, the average total funding per student was $2,476 in these districts. In fiscal year 1994-95, the average was $3,254, an increase of about 32 percent. The remaining school districts experienced a 23.10-percent increase in their average total funding per pupil over that same period, with the average per pupil funding increasing from $3,117 to $3,782.

The Tennessee Department of Education has been keeping track of how the additional funding made available under the Basic Education Program has been spent. In a 1994-95 budget report that accounts for about $275 million of the new funding[39] under the program, classroom expenditures represented about 80 percent of the new money. Classroom expenditures include the hiring of new personnel, such as teachers, counselors, librarians, and principals, and the purchasing of supplies such as textbooks, instructional materials, and technologies. Within this

[39]About 3 percent of the $275 million in new funding included reserves from the prior year.

expenditure category, the largest single portion (about $100 million) was spent on reducing class sizes in kindergarten through eighth grade by hiring 2,999 new teachers. Nonclassroom expenditures accounted for the remaining 20 percent of the new money, with about $25 million of the amount going for the construction and renovation of classrooms.

Greater Educational Opportunities, Especially in Poor Districts

Nearly all the officials we interviewed indicated that the impact of new money on small, rural districts has been significant. A former legislator said that an estimated 70 to 80 small, rural districts can now provide educational opportunities to their students that they could not offer before. For example, he said that schools for the first time have art and music teachers and can offer courses that will better prepare their students for college. These improvements, in turn, will help enable such schools to receive accreditation from the Southern Association of Colleges and Schools.

More Local Flexibility

The Tennessee Department of Education reported that the use of state education funds has much more flexibility under the Basic Education Program formula than it had under previous state funding programs. Officials we interviewed, including two legislators, a small district superintendent, and a state school board association official, agreed with the Department's assessment, citing flexibility in decisionmaking as a benefit. The funding formula groups components of basic education into classroom and nonclassroom categories. The formula's only earmark is on classroom funds, which must be spent on classroom components but not necessarily on the specific classroom cost component that generated the funds. As an example of the flexibility possible in local spending decisions, a superintendent said that district officials may receive funding to hire a nurse but instead may decide to use the funds to hire a teacher or purchase technology or some other classroom-related item.

Cost-Based Finance System

The old formula based its funding levels on appropriated amounts; the new formula links funding to the costs of 42 critical components, such as teachers and textbooks, associated with providing a basic education. The Department of Education annually reviews and updates the components' costs. One or both of these features—the inclusion of a wide array of cost components and the annual review—were among the benefits cited by officials we interviewed, including a Tennessee State Education Board official, the Chair of the House Education Committee, and representatives

of the state teacher union and school board association. As the State Education Board official explained, the state now has a mechanism for automatically increasing funding to meet increasing enrollment and cost. He explained that, previously, funding for items, such as transportation, had remained the same for a 6- to 8-year period, despite an approximate 33-percent increase in the school enrollment.

Concerns Remain Over Sustaining Equity in Funding

Although acknowledging improvements, officials we interviewed also identified several concerns about the new school finance system. The five concerns most frequently cited involved (1) the growing antitax sentiment among property owners, (2) the exclusion of teacher salary increases from the finance plan; (3) the lack of limits on local contributions; (4) the high educational costs of poor, urban students; and (5) the new accountability system.

Because of a lawsuit, the state has since modified its finance system to include increases in teacher salaries. Depending on how concerns about the antitax sentiment, the lack of limits on local spending, and the needs of the urban poor are handled, some officials indicated that inequities in the school finance system could recur.

Antitax Sentiment a Growing Concern

Given that localities are required to pay a prorated share toward the cost of their district's basic education, officials we interviewed questioned the willingness of localities to raise their taxes to keep pace with the cost of components, such as teacher salaries, that are expected to increase over time. As a state school board official explained, the Education Improvement Act required schools to comply with reduced class sizes 4 years from the date of full funding for the new school finance plan. This provision, he said, will create significant upward pressure on localities' contributions, and counties will be dismayed when they learn how much they will need to contribute to earn the state share. A state board of education official said that, as a result, constituents would pressure their state representatives to change the formula to avoid raising taxes to finance their local contribution. If the local share were to be reduced, the official said the state may find it more difficult to ensure the adequate and equitable financing of education needs in all districts.

Program's Failure to Increase Teachers' Salaries Challenged

The Tennessee Small School Systems representing the 77 small, rural districts who had filed the original 1988 lawsuit brought suit challenging the provision in the Education Improvement Act that new funding under

the Basic Education Program could not be used to increase salaries of existing teachers. The plaintiffs contended that the new funding scheme was unconstitutional because equalization would occur over several years and the plan included no provision to equalize or increase teacher salaries. In its February 1995 opinion, the state supreme court upheld the plan's constitutionality, accepting the state's argument that complete equalization of funding can best be accomplished incrementally but found that the plan's failure to provide for the equalization of teachers' salaries was a significant defect which, if not corrected, could put the entire plan at risk. The court stated, "Teachers, obviously, are the most important component of any education plan or system, and compensation is, at least, a significant factor determining a teacher's place of employment." Underscoring the importance of the program's key provisions for funding and governance, the court approved Tennessee's Basic Education Program. Since the court order, the 1995 Tennessee State Legislature has appropriated $7 million of the estimated $12 million needed to equalize increases in teacher salaries.

No Limits on Local Spending Pose a Concern

Although the Education Improvement Act mandates a minimum local contribution, it does not limit the amount of the contribution. A superintendent of one of the plaintiff districts stated, "To impose caps to limit local taxing authority in the name of equality or uniformity of education has no place in a new [finance] system." Other officials—including a state attorney and a state legislator, however, suggested that some districts may be very willing to contribute to their local schools, and over time disparities between rich and poor districts may again grow to some unacceptable level.

Educational Needs of Urban Poor May Not Be Met

Officials, including two state education officials and a state attorney, indicated that the Basic Education Program formula may not adequately address the needs of the urban poor who reside in counties with high fiscal capacities. An official with the Tennessee Advisory Commission on Intergovernmental Relations said that the formula makes no allowances for the likely higher-than-average unit costs associated with serving the educational needs of a large, dense population of students—many of whom can be characterized as poor or at risk—in the urban districts. Compounding the problem of not receiving perhaps adequate funding for their students' educational needs, he also said that urban districts have relatively high fiscal capacities and therefore their state funding increases have been proportionately smaller compared with the increases in districts

with lower fiscal capacities, which are typically more rural. Finally, the state does not have any requirement for counties to "weight" the distribution of state or local funds to their school districts according to the district's share of poor or at-risk students in the county.

Some Accountability Provisions Continue to Be Challenged

Officials we interviewed expressed concern about the reaction of groups affected by certain accountability provisions in the Education Improvement Act. For example, the Chair of the House Education Committee said that members of the legislature have made repeated attempts to repeal provisions related to the election of school board members and the board appointment of district superintendents. The provisions in Tennessee's pioneering new approach for measuring gains in student performance—the Value Added Assessment System—also sparked controversy. The new assessment system measures gains in student performance in grades three to eight and compares them with national average gains in those grades over the most current 3-year period. Observations made by officials, including two state education officials, a legislator, a teacher union representative, and a district superintendent indicated that the new system is problematic—although a key legislator said he believed the problems can be worked out. Problems cited by respondents in our group included (1) difficulties in holding schools accountable for achieving certain performance goals before the Basic Education Program is fully funded; (2) premature student testing—that is, conducting tests before students have had an opportunity to learn the material; and (3) bad publicity caused by early results that only showed small increases in better schools.

Minnesota Case Study

In 1988, 52 school districts with below-average property wealth sued the state of Minnesota for providing—in alleged violation of the state constitution—unequal access to education revenue and unequal education opportunities. Unlike some other states, about 90 percent of Minnesota's education revenues were already subject to wealth- and need-based equalizing formulas. At issue was about 7 percent of general education revenue for elementary and secondary education.

Although the Minnesota Supreme Court ruled in 1993 that the finance system was constitutional, the Minnesota State Legislature moved forward with plans to equalize some of the remaining funding. To do so, legislators had to balance three competing interests: (1) increasing funds available to less wealthy districts, (2) dealing with growing pressures for tax relief from business and other property owners, and (3) assuaging the concerns of high-spending districts that they might lose revenue because of changes to the system.

The legislature's revisions have improved the fairness of the system, according to almost all the officials and education advocates we interviewed. However, issues that have emerged since the revisions—districts' ability to pass tax levies in an antitax environment and the rapidly growing costs of educating children with special needs—have created additional problems that may raise new concerns about finance equity.

Background

We determined that in fiscal year 1995-96, public school districts in Minnesota were projected to receive more than $5.5 billion from federal, state, and local sources. More than half of that was provided by the state, and about 44 percent was provided by localities. The federal government contributed the rest. Since fiscal year 1986, Minnesota has spent more on primary and secondary education than it has on any other single major state program, amounting to about one-third of most recent state expenditures. Since 1983, the state's share of total district revenue, relative to local and federal contributions, has dropped below 50 percent only once and has been as high as 55 percent. State appropriations for public schools are funded primarily by statewide income and sales taxes. The local contribution is funded primarily with local property taxes.

Understanding how Minnesota funds education helps to better explain the pursuit of revenue equity in the state and how it differs from such pursuits in states where much wider disparities existed. Elementary and secondary

schools receive the bulk of their general operating funds and levy authority from the state through the General Education Revenue Program, a program subject to wealth equalizing formulas. Nearly three-fourths of the total state funding for elementary and secondary education is distributed to school districts through this program. The remaining one-fourth of the state's appropriation is for special-purpose or categorical aids, some of which also are wealth and cost based.

The General Education Revenue Program entitles each district to a specified revenue allowance per pupil, with additional allowances allocated on the basis of economic, geographic, and other cost-related circumstances of the district. The "basic revenue allowance," without the cost-related adjustments, was $3,150 per pupil unit[40] in fiscal year 1995-96. The state pays the district the difference between what a district can raise at a statewide tax rate[41] and its basic revenue allowance.[42] The proportion of general education aid received by each district depends on the district's relative property wealth per pupil. A few very wealthy districts receive no general education aid, while relatively poor districts receive most of their general education revenue as state aid payments.

In addition, districts may also supplement this basic funding by implementing a voter-approved operations tax levy.[43] Revenue raised by voter-approved operations levies constituted about 6 percent of total district revenue in 1994. The optional operations tax levy was at the heart of the dispute about funding equity.

Disparities in Spending and Unequal Access to Revenue Prompt 1988 Lawsuit

As in Texas and Tennessee, a lawsuit prompted action to revise Minnesota's finance system. The suit was brought in 1988 by rapidly growing school districts whose property wealth per pupil had dropped below the state average. The suit alleged that the education finance system violated two provisions of the state constitution: its education clause (which requires a "general and uniform system of public schools") and its

[40]Per pupil unit is a weighted count of resident pupils in average daily membership used in the calculation of state aid and local tax levies.

[41]During our visit, this rate was 34.2 percent of taxable property wealth.

[42]At the statewide tax rate, a few property-rich districts raise levies in excess of the general education allowance. The amount by which the general education levy exceeds the general education allowance is deducted from other categorical aid to the district. A few districts raise more than their total general education allowance plus categorical aids. These districts are allowed to reduce their tax rate and receive no state aid.

[43]The state calls this "excess referendum revenue."

equal protection clause (which provides that a citizen may not be deprived of any right or privilege). This challenge was to a relatively small portion of Minnesota's funding structure because more than 93 percent of Minnesota's general education revenue already fell under wealth-and cost-based funding schemes. Plaintiffs contended that the failure to equalize the remaining 7 percent of this revenue left too much discretion with local officials and permitted wealthy districts to generate much more additional funding than low- or average-wealth districts. The lawsuit challenged three types of state funding programs: (1) voter-approved operations tax levy; (2) revenue guarantees typically benefiting high-spending, wealthy districts; and (3) local debt service levy approved by voters to finance bonds for school construction and renovation.

The court found that the constitutional requirement for a "general and uniform system" of public schools does not mandate complete funding equalization and that any inequities that existed did not actually violate the constitution's education clause. Nevertheless, the legislature continued to implement revisions it had begun in 1991 to further reduce the disparities between wealthy and less wealthy districts.

Legislators Balance Competing Interests to Accomplish Levy Equalization

To improve fiscal equity in Minnesota, legislators said they found they had to balance three competing interests: (1) increasing funds available to low-property wealth districts, (2) dealing with growing pressures for tax relief from business and other property owners, and (3) assuaging the concerns of high-spending districts that they might lose revenue because of changes to the system.

Legislature Equalizes Optional Levy Programs

Unlike other states, where legislatures made significant structural changes to the school finance system to affect equity, the Minnesota State Legislature made minor changes within the existing system, education leaders and state officials said. Legislative revisions principally focused on voter-approved operations and debt service property tax levies. Beginning in 1992, state aid was provided to equalize a portion of the optional operations tax levies. It also began debt service equalizing aid that year.

The state's tactic to improve equity in the levy programs was to calculate an aid contribution per district in the same manner as it calculated the state's share of the district's General Education Revenue. Equalizing aid was provided to districts passing levies in a proportion similar to that received by them under the equalized General Education Revenue

program. State aid was provided to equalize a portion of the optional levy. Initially, only $305 per pupil unit raised by the voter-approved operations tax levy was subject to this equalizing scheme.[44] The debt service levy equalization aid was phased in over 3 years, at a lower rate of equalization than operations levies, and was made available only to districts whose debt service exceeded 10 percent of their taxable base per pupil. The need to provide additional revenue for some districts was complicated by other pressures on the state budget, according to one former member of the education finance committee in the Minnesota House of Representatives. When these changes were being considered, the state also had growing health care costs due to expanded coverage and enrollment growth and growth in corrections costs due to harsher sentences and improved law enforcement. We found that health care spending increased over 47 percent between fiscal years 1988 and 1991. Corrections spending was up almost 42 percent in the same period.

Legislation Provides Tax Relief

State legislative officials and education advocates said that education finance negotiations included pressures from business interests and tax reformers who wanted to make property tax relief part of education finance reform. Of interest to business was the state's property tax system, which taxed different types of property used for different purposes at significantly different rates. The lowest tax rates were applied to agricultural property. The highest rates were applied to commercial property. Business leaders, whose commercial property could be taxed at more than four times the lowest residential homestead property rate, wanted changes. In addition, one group sought to cap statewide property tax rates for operations levies. State law did not limit tax rates for optional levies.

To deal with these concerns, legislators made several changes. Initially, these changes included the following: They voted to terminate all operations levy authority by July 1, 1997, forcing districts to go back to the voters for any renewal. In addition, they limited all operations levies to 5-year terms. Specifically to respond to business concerns about tax fairness, the legislature began to phase in a market value-based property tax system for optional operations levies. After 1997, commercial property was to no longer be taxed at a higher rate than homestead and other property. Finally, the legislature capped the amount of optional operations levy revenue that a district could raise. In effect, this limited districts'

[44]According to state law, this amount is 10 percent of the basic revenue allowance, or $305 of $3,050 in 1992. In 1994, the allowance increased to $3,150 and the maximum guarantee increased to $315.

property tax rates for optional operations levies, which had not previously been limited by state law. Initially, the revenue limit was set at 35 percent of the basic revenue allowance but was further reduced to 25 percent in 1993.

Legislation Protects District Revenues

Members of the legislative committee addressing education finance issues said some high-spending districts were concerned that revisions to the finance system might reduce their revenue, create fiscal hardship, and harm the quality of their education programs. These districts sought revenue protections and were supported by their legislators.

For example, most districts' optional operations levy revenue was below the statutory limit, though a few districts exceeded the limit, legislative officials said. Districts located in sparsely populated areas were not subject to revenue limits. In addition, suburban metropolitan districts experiencing declining enrollment were allowed to retain their excess revenue. Additional protective measures that the legislature passed were to postpone the statutory expiration date for optional operations levies from 1997 to 2000, and to extend the 5-year term limit on newly passed levies to 10 years. Districts have options to extend these levies further if they convert their levies to a market-value base.

The legislature also continued a state revenue program specifically challenged as unfair by plaintiff districts in their equity suit against the state. This program guarantees districts revenue that might otherwise have been reduced due to changes in the school finance system. One legislative fiscal analyst said that it is unlikely this program will be eliminated, although funding is being reduced, because a handful of districts greatly depend on these dollars.

Finance Reforms Improve Equity, but Other Problems Emerge

Legislative and education officials and education advocates generally agreed that equalizing optional property tax levies had made the finance system fairer. However, education leaders in particular said that several additional problems have emerged since the revisions and these problems remain unresolved.

Revenue Equity Improves

Legislative and education officials and education advocates generally agreed that the new equalizing levy aid program has moved the state closer to a finance system in which equal tax effort generates equal revenue per

pupil unit among districts. For example, we found that the differences in relative tax burden between the state's highest property wealth and lowest property wealth districts has diminished since the 52 school districts filed suit in 1988. According to a document prepared by plaintiff districts, the tax rate for the poorest districts was on average almost one-fourth higher than that for the wealthiest districts.[45] By 1992 and 1993, however, we determined, on the basis of State Department of Education data, that this disparity had diminished to just over 6 percent.

Furthermore, we also determined that in 1988 a less wealthy district falling at the 10th percentile generated expenditures of $59.57 per pupil for every percent of tax levied, compared with $84.98 per pupil for every percent of tax levied in a wealthy district at the 90th percentile. By 1992 and 1993, however, the per pupil expenditures for every percent of tax levied were essentially equal in two districts falling at the 10th and near the 90th percentiles in wealth. A less wealthy district generated $129.58 in expenditures per pupil for every percent of tax levied compared with $132.25 per pupil in a wealthy district.

Differences in spending, which the state supreme court found were largely justified by differences in operating costs and pupil needs, have not changed significantly since 1988. In 1992-93, the district at the 95th percentile in per pupil operating expenditures was spending 54 percent more than the district of the 5th percentile. The disparity surpassed that in 1988, when the difference was 48 percent per pupil. The legislature has required, however, that if the spending gap between the districts at the 5th and 95th percentiles in general education revenue begins to increase significantly, the state Department of Education will devise a plan to reduce that growth and recommend that plan to the legislature.

Antitax Sentiment and Increasing Education Costs Create Additional Problems

State education leaders pointed out two problems that have emerged since equalizing legislation was introduced for optional levies. These problems, which concern public support for taxes and growing education costs, may affect state efforts to achieve improved finance equity. First, voter resistance to taxes is growing. As a result, fewer districts can pass optional levies, officials said. For example, voters in one such district near St. Paul twice rejected the renewal of an existing optional operations levy in 1994. The loss of about $350 per pupil unit caused the district to lay off about 70 teachers in 1995, the superintendent said. Voter discontent with taxes

[45]The Association of Stable or Growing School Districts, Factual Issues Addressed and Answered by Court Decision in Funding Equity Lawsuit, Minneapolis, undated.

overall and the property tax in particular affected the outcome of the referendum, he said. According to one state finance official, no real growth has occurred in the proportion of districts statewide passing operations levies. This has occurred while the state has increased equalizing aid for districts passing levies. The ability of some districts to pass levies, when other districts cannot, will affect spending disparities in the state, education advocates said.

The second emerging problem is that the number of special needs students requiring costly special education programs is creating fiscal pressures statewide, state officials and education advocates said. While state appropriations for the basic revenue allowance have increased only 10 percent between 1991 and 1995, aid for remedial education, special education, and limited English proficiency are up 75 percent, 103 percent, and 37 percent, respectively. Several people we interviewed said that, although the state has increased aid for special needs children, aid has not kept up with the costs of educating them.

The director of the organization representing the 52 school districts that brought the 1988 suit said that some districts have been hit harder by this growing population than others. For example, we determined that the Osseo School District in school year 1987-88 was spending $277 per pupil on special education services, but by 1992-93, its special education spending had almost tripled to $766 per pupil. Another district struggling with increasing costs has been the Minneapolis School District, where a large proportion of the children enrolled are from economically disadvantaged backgrounds and are of ethnic minorities. During our visit, this district was considering another lawsuit against the state. Even though the district has among the highest tax bases in the state and spends more per pupil than 95 percent of the state's districts, it is not enough, a policy official with the district said. Academic achievement by minority students has been below national averages.

Education advocates pointed out that state aid to districts reflects the amount of money the state has available to fund education, rather than the cost of providing it. Although the legislature established a commission in 1993 called the Coalition for Education Reform and Accountability to both define and estimate the cost of ensuring a "basic education," the legislature has not acted on the coalition's assessment and recommendations. The legislature did not renew the coalition's funding in 1995. Legislative and education officials said the coalition defined "basic education" very broadly and indicated that a significant increase in

education spending by the state would be required. Given existing budgetary constraints, it is unlikely that the coalition's recommendations will be implemented, state finance officials said.

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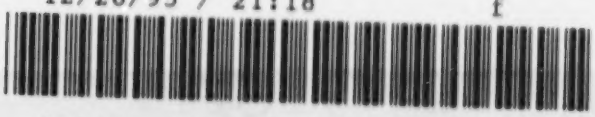

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